

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

PEOPLE OF THE STATE OF NEW YORK, by
Letitia James, Attorney General of the State of
New York,

Plaintiff,

-against-

EXXON MOBIL CORPORATION,

Defendant.

Index No. 452044/2018

IAS Part 61

Hon. Barry R. Ostrager

EXXON MOBIL CORPORATION'S PRE-TRIAL MEMORANDUM

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Defendant Exxon Mobil Corporation (“ExxonMobil”) respectfully submits this brief addressing the issues to be resolved at trial.

PRELIMINARY STATEMENT

This case is not about climate change, climate science, or climate policy. It is also not about whether ExxonMobil considers climate risks in its long-term business planning. ExxonMobil indisputably considers those risks. For more than a decade, ExxonMobil has evaluated how climate regulations might affect both the demand for its products and the costs its potential investments might bear. Reasonable investors who reviewed ExxonMobil’s disclosures understood that climate risks factored into ExxonMobil’s decision-making, which is all that could have mattered to them. Those investors also understood that ExxonMobil did not disclose the proprietary details about how it weighed those risks.

That was the state of affairs when the Attorney General for the State of New York (“NYAG”) commenced its investigation of ExxonMobil and announced with great fanfare that it was going “to step into this battle” over climate policy by using its powers “aggressively” and “creatively.” (DX 706 at 2, 4.) The NYAG obtained over four million pages of discovery from ExxonMobil and interviewed over 40 individuals from the company, its independent auditor, and other third parties. But after devoting three years to making a case against ExxonMobil, and whipping up high expectations in the press and among climate activists, the NYAG found no evidence of wrongdoing: no whistleblowers, no accounting restatements, and no documents revealing a fraud or cover-up.

Having boxed itself into a corner, the NYAG filed a complaint against ExxonMobil anyway. Its entire case rests on a single sentence in a single paragraph in the middle of a 30-page report issued in 2014. The paragraph begins with a description of how ExxonMobil assumes a “proxy cost of carbon” to account for “future climate-related” regulations when projecting global

demand for energy out to 2040. (PX 001 at 17.) The paragraph then shifts to a discussion of capital investments and says, “Perhaps most importantly, we require that all our business segments include, where appropriate, GHG costs in their economics when seeking funding for capital investments.” (*Id.* at 18.) That sentence is the focal point of the NYAG’s case. To the NYAG, that sentence means ExxonMobil “described its proxy cost as a unitary concept that applies across its business units and functions.” (DX 678, Compl. ¶ 94.)

That is emphatically not what the sentence, the paragraph, or the document said. ExxonMobil uses two sets of assumptions to evaluate the impact of potential future climate regulations: the proxy cost of carbon (for global energy demand) and GHG costs (for expenses of contemplated investments), and it never described them as a “unitary concept.” It also never said that GHG cost assumptions are “applied across business units and functions.” Rather, the report expressly and unambiguously stated that those cost assumptions are applied only when “seeking funding for capital investments” (*i.e.*, potential investment opportunities) and, even then, only “where appropriate.” (PX 001 at 18.)

Investors reading that passage would have no ability to predict when ExxonMobil would consider it “appropriate” to apply those assumptions or what criteria ExxonMobil used to gauge “appropriateness.” The “where appropriate” caveat cautioned investors that ExxonMobil was not guaranteeing a uniform or mechanical application of GHG costs across ExxonMobil’s various investment opportunities in myriad jurisdictions. As for the assumptions themselves, ExxonMobil further made clear it does “not publish the economic bases upon which [it] evaluate[s] investments due to competitive considerations.” (*Id.* at 16.) No reasonable investor would interpret the paragraph as the NYAG does in this litigation, and no reasonable investor was misled.

Most importantly, the report accurately described the approach ExxonMobil has taken for over a decade when evaluating climate regulatory risks. If climate regulations are enacted, they could potentially affect ExxonMobil's business in two ways: by reducing demand for energy and increasing the expenses of specific operations.

In 2007, ExxonMobil developed the proxy cost of carbon to model the potential effects of regulations, regardless of whether energy consumers or producers bore the cost, which could reduce the demand for carbon-based energy sources. The proxy cost of carbon was then incorporated into ExxonMobil's decades-long efforts to model the global demand for all forms of energy (not just those produced by ExxonMobil). Around the same time, ExxonMobil developed a different assumption, GHG costs, to capture costs that potential climate regulations might impose directly on the emissions generated by specific projects. That cost assumption was used, where appropriate, to evaluate the future expenses of potential capital investments.

The difference between these metrics is not about semantics or labels (including those invented by the NYAG and its experts); it is about substantial business realities. In particular, if a tax on emissions affects consumers, but not operators, it would be relevant to the proxy cost of carbon, but not GHG costs. These are different metrics developed and used for different purposes to aid ExxonMobil's long-term business planning.

At bottom, the NYAG's case does not add up. The NYAG claims that ExxonMobil's default GHG cost assumptions (none of which were ever disclosed to the public) were not applied uniformly and should have had the same values assigned to the proxy cost of carbon (which were not disclosed with any specificity, other than to indicate variation by time and region). Such differences could not have deceived investors who had no visibility into ExxonMobil's process for making investment decisions, much less how GHG costs may have influenced that process.

Accordingly, if anyone would have been misled by the use of inaccurate GHG cost assumptions, it would have been only ExxonMobil itself. But ExxonMobil had no reason to deceive itself into making bad investments.

ExxonMobil also had no reason to deceive investors about these assumptions. Investors wanted to know whether ExxonMobil had developed tools to take climate regulatory risks into account—and ExxonMobil indisputably has done that. Investors, including the NYAG’s own witnesses, were not concerned with the particular assumptions reflected in those tools and had no basis to say whether the assumption was right or wrong. (*See, e.g.*, Lamb Tr. 138:23-140:20; Garland Rough Tr. 67:13-68:6.) It is simply fanciful for the NYAG to maintain that reasonable investors considered it material whether ExxonMobil evaluated potential investments *in the year 2040* using an assumption of \$80 per ton,¹ \$60 per ton, or some other amount to account for highly uncertain potential regulatory costs that no one, including the NYAG, claims to be able to estimate reliably. Such assumptions would have no direct impact on ExxonMobil’s balance sheet, income statement, or any other financial disclosure. That doubtless explains why ExxonMobil’s stock price did not react to the disclosure of the paragraph the NYAG labels confusing or to the NYAG’s disclosure of its allegations against ExxonMobil. None of this mattered to a reasonable investor.

It matters to the NYAG, on the other hand, because four years ago the NYAG made a public commitment to do “battle” with ExxonMobil as a way of addressing climate change. ExxonMobil agrees that climate change presents a serious challenge that warrants creative thought and constructive action. But baseless litigation, like the NYAG’s lawsuit, merely distracts from the serious work that needs to be done. The complaint in this case may fulfill the NYAG’s press-

¹ Carbon prices are expressed on the basis of tons of carbon dioxide emitted.

conference commitment, but it fails to identify any fraud or misrepresentation. The Court should enter judgment in ExxonMobil's favor.

STATEMENT OF FACTS

I. ExxonMobil Evaluates the Potential Effects of Potential Climate Regulations.

For nearly two decades, ExxonMobil has acknowledged that “the risk of climate change and its potential impacts on society” present significant challenges that should be addressed by governments throughout the world. (DX 778 at 10.) When considering how the energy industry might be affected by government action to combat climate change, ExxonMobil identified two potential consequences:

1. Climate regulations might depress consumer demand for carbon-based energy sources; and
2. Climate regulations might impose direct costs on energy producers for the GHG emissions generated by particular projects.

ExxonMobil evaluated both potential impacts, and it had good business reasons to do so. Regulations that might affect the demand for energy or the cost of operations could be relevant to its business, and their impacts needed to be understood.

A. ExxonMobil Uses a Proxy Cost of Carbon To Evaluate How Climate Regulations Might Affect the Global Demand for Energy.

Global energy demand is a critical input of ExxonMobil's business planning, and ExxonMobil has analyzed that demand for decades. This analysis is not focused narrowly on ExxonMobil, or even on the forms of energy that ExxonMobil develops and distributes. It covers all forms of energy and all demand for energy throughout the world. ExxonMobil began sharing its outlook with the public in 2006 when it first published what has become an annual report called the *Outlook for Energy*. (See DX 601.) A team of ExxonMobil analysts who prepare the *Outlook for Energy* are assigned full-time to analyze energy demand, the variables that affect demand, and

the likely sources of supply to meet that demand. Their analysis helps to develop ExxonMobil's long-term oil and gas price assumptions.

Starting in 2007, when climate regulations were in their infancy, ExxonMobil introduced a new variable into its process for estimating future energy demand. That variable, called the "proxy cost of carbon," was meant to measure, at a macroeconomic level, the impact of all carbon dioxide policies and regulations on global energy demand. (DX 628 at EMC 003203429.) Because climate regulations would likely make oil and gas more expensive to consumers, the effect of the proxy cost of carbon, all else being equal, was to reduce projected future demand for oil and gas. The proxy cost was set in 2007 based on an analysis of "the potential economics of carbon capture and storage projects and what carbon price might be needed to provide some economic flooring for those products versus other alternatives." (Onderdonk Tr. 210:13-17.) The team also "focused on the emissions trading system in Europe and the price levels indicative in that market." (*Id.* at 211:11-14.) Since then, the proxy cost has been used continuously as a critical assumption whenever there is not a more accurate way to estimate the effect of myriad and varied climate regulations on energy demand in different sectors.

Demand projections, when compared to estimates of supply, generate important signals about future energy prices. ExxonMobil's assumptions about future oil and gas prices, known internally as "price bases," are set by senior management after careful analysis and consideration of demand and supply projections, along with a variety of other factors. (DX 651.) As former chief executive officer Rex Tillerson testified, "the proxy cost was always applied here at the demand side, and then ultimately that demand/supply balance would play into our view of what . . . pricing may be in the future." (Tillerson Tr. 37:18-22.) ExxonMobil's price bases are considered proprietary information and can be found only in internal company records, such as the

Corporate Plan Dataguide (the “Dataguide”). (E.g., DX 624 at 7-8.) ExxonMobil employees use the Dataguide’s price bases to prepare budgets, analyze potential investments, and evaluate assets. As shown in Figure 1 below, the proxy cost of carbon is embedded in the price bases that are used to evaluate new investment opportunities and plays an indirect role in decisions about which opportunities to pursue.



Figure 1: The proxy cost of carbon is embedded in ExxonMobil’s price bases.

B. ExxonMobil Uses GHG Costs To Evaluate How Climate Regulations Might Affect the Expenses of Contemplated Investments.

ExxonMobil addressed the other potential impact of climate regulations—direct costs imposed on operations—through a planning assumption generally called “GHG costs.” A planning and budgeting group within ExxonMobil developed that assumption around the same time that the *Outlook for Energy* team developed the proxy cost of carbon. (DX 779 at 33-34.) Critically, however, GHG cost assumptions were developed for a different purpose unrelated to the demand for energy. In jurisdictions where potential climate regulations might impose costs directly on the emissions generated by a potential investment, the profitability of that investment might be diminished. GHG costs therefore evaluate, where appropriate, how future climate regulations might raise the projected expenses of a particular potential investment. As an internal

planning assumption applied to investments that are not yet funded, GHG costs have no direct impact on ExxonMobil's income statement, balance sheet, or any other publicly reported metric. The GHG cost assumption is simply a planning tool used where appropriate in internal cash flow models to analyze potential investment opportunities.

GHG costs were at first a relatively rudimentary tool, and ExxonMobil initially applied them only to areas covered by the European Union's Emissions Trading Scheme. (DX 614 at 34.) They were "intended to hopefully be realistic, but we weren't explicitly trying to make what I would call a projection of the future." (Eizember Tr. 43:6-8.) These assumptions appeared in the Corporate Plan Dataguide Appendices. (Figure 2; DX 623 at 31-32.) Like the price bases discussed above, which also appear in the Corporate Plan Dataguide (Figure 2; DX 624 at 7), ExxonMobil considered its GHG cost assumptions confidential and proprietary. (Tillerson Tr. 157:23-158:4.) They were not disclosed to the public.

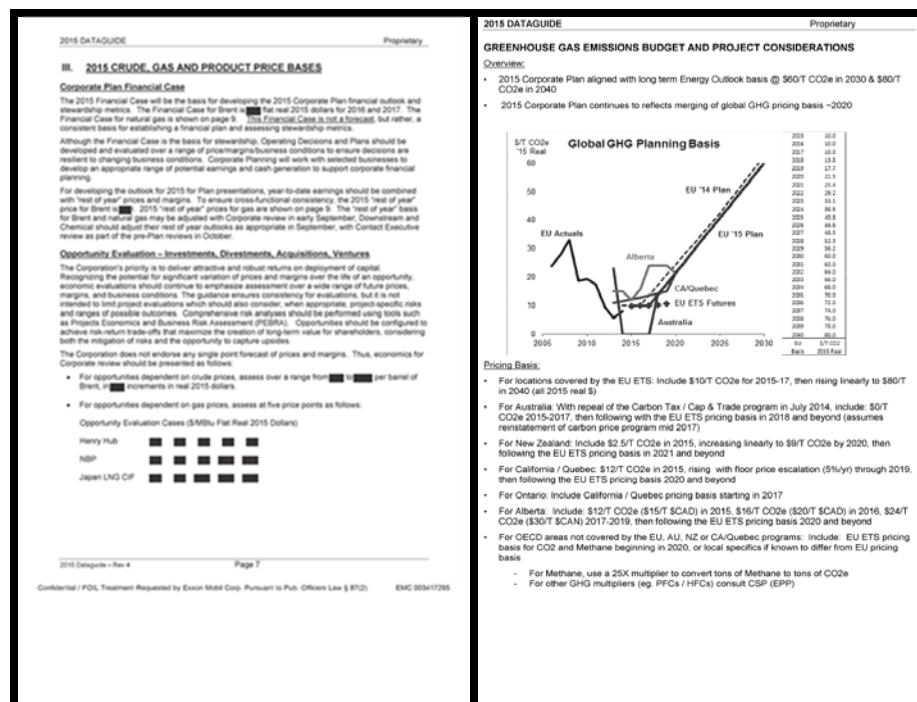


Figure 2: The 2015 Corporate Plan Dataguide (left) contained that year's price bases, and the Appendices to the Dataguide (right) contained that year's GHG cost guidance.

Like any assumption, the GHG cost guidance was a starting point for analysis, and the guidance itself recognized that its application in a particular case might not be appropriate. (Iwanika Tr. 72:19-25; DX 623 at 32.) For example, some projects could account for regulatory costs through an environmental permitting process. (DX 645.) Requiring those projects to use default GHG cost assumptions would have improperly double counted the regulatory burden. Likewise, local knowledge about regional regulations might suggest a planning assumption more appropriate than the default GHG cost assumption set at the corporate level for use in various jurisdictions. (Tillerson Tr. 153:25-154:5.) That is why the Dataguide encouraged employees using GHG cost assumptions to consider local specifics and to consult experts within ExxonMobil about appropriate assumptions in a given case. (DX 623 at 31; JX 919 at 37.) In circumstances where the default GHG cost assumptions in the Dataguide were not appropriate for a particular project, the managers worked with a GHG specialist to apply an alternative approach better suited to the circumstances at hand. (Powell Tr. 208:11-22.)

Applying an appropriate assumption for GHG costs (rather than mechanically applying a uniform default assumption) was ExxonMobil's objective, and for good reason. When considering whether to make a capital investment, ExxonMobil expected to use the best available information. If the default assumptions in the Dataguide were not the best information available, it would hardly serve ExxonMobil's interests (or those of its shareholders) to use those assumptions uniformly. Sound investment decisions required a basis in sound analysis. If the analysis suggested one investment opportunity was less attractive than another, ExxonMobil would be able to select the more attractive option. In that manner, the "where appropriate" GHG cost assumptions were designed to facilitate sound investment decisions.

C. The Proxy Cost of Carbon and GHG Costs Are Different Assumptions That Serve Different Purposes.

ExxonMobil developed two metrics (the proxy cost of carbon and GHG costs) to address the two effects that climate regulations might have on its business (*i.e.*, lower energy demand and higher operational costs). While both assumptions pertained to highly speculative events decades in the future and both were used in long-term planning, they differed in several material respects, as shown in Figure 3 below. Most importantly, the type of climate regulations that each captured was fundamentally different. The proxy cost of carbon evaluated the total impact of regulations that might suppress demand for energy—whether borne by energy producers, consumers, or some other party. This analysis was not limited to ExxonMobil’s projects or operations; it applied to global demand and supply of energy. GHG costs, on the other hand, evaluated only the regulations that might be borne directly by potential ExxonMobil projects based on their emissions.

Proxy Costs	GHG Costs
<u>Macroeconomic</u>	<u>Microeconomic</u>
Reflect <u>all</u> climate policies across globe	Reflect regulations imposing <u>direct costs</u> on operations
Applied in demand models, the output of which influences capital investments	Applied, where appropriate, in project economics when seeking funding for capital investments
Affects price bases in Dataguide, used in project economics for investment analysis	Appear as expense assumptions in Dataguide, used in project economics for investment analysis

Figure 3: The proxy cost of carbon and GHG costs are distinct planning tools.

The proxy cost of carbon, therefore, sweeps in a wider array of regulatory burdens than do GHG costs. For example, fuel efficiency standards and gasoline taxes that consumers pay at the pump are not part of a producer’s operating expenses. As a result, proxy costs can be expected to

be higher than GHG costs, particularly in the short term when a variety of diverse regulations might be enacted.

The long-term outlook, however, presented the question of whether countries would converge around a preferred policy. ExxonMobil considered that question internally for a number of years. (JX 926 at EMC 000354827.) From 2007 to 2014, GHG cost assumptions were lower than the \$80 per ton proxy cost assumption used in 2040 because of the broader reach of the proxy cost. (E.g., JX 921 at 31.) After evaluating developments among OECD countries, in June 2014, ExxonMobil assumed for planning purposes that those countries eventually would converge on using a carbon tax to address climate change, which was consistent with ExxonMobil's long-standing support for a revenue-neutral carbon tax. As ExxonMobil's former Greenhouse Gas Manager testified, "this mosaic, if you will, of policies that exist today, will melt together into a consistent price o[f] carbon at some point in the future," particularly in the OECD. (Powell Tr. 279:4-7.) ExxonMobil, therefore, adopted common assumptions for the proxy cost of carbon and GHG costs in OECD countries starting with the year 2030. The use of common assumptions after that year did not alter the fundamental differences between these two metrics. It simply reflected ExxonMobil's reasoned belief that the climate regulation most likely to be found in OECD countries after 2030 would be relevant to both the proxy cost of carbon and GHG costs.

II. ExxonMobil Accurately Disclosed How It Evaluates Climate Regulations.

ExxonMobil did not develop its proxy cost of carbon and GHG cost assumptions as a public relations exercise. It did so for the business reasons outlined above, and ExxonMobil sought out no publicity or praise for what it was doing. In its annual *Outlook for Energy* publication, ExxonMobil informed the public in broad terms about its use of a proxy cost of carbon to reduce energy demand. But ExxonMobil did not make its first public statement about using a GHG cost assumption in investment analysis until *six years* after developing that assumption. Even with

those limited statements, ExxonMobil's disclosures were more robust than those of other energy companies. State Street's Rakhi Kumar (one of the NYAG's witnesses) has acknowledged that "few companies can effectively demonstrate to investors how they integrate climate risk into long-term strategy" and "most companies in the [United States] do not disclose their carbon price assumptions." (PX 122 at 1, 2.) ExxonMobil thus faced no pressure to "keep up" with the disclosures of its peer firms, but it nonetheless made good-faith efforts over time to respond to investor inquiries about how ExxonMobil took potential climate regulations into account in its business planning.

A. ExxonMobil Discussed the Proxy Cost of Carbon in Relation to Energy Demand.

In 2008, ExxonMobil first alluded to its use of a proxy cost of carbon to evaluate future demand for energy. In that year's *Outlook for Energy*, ExxonMobil acknowledged that "the *Outlook* anticipates that cost of carbon policies will be adopted in the U.S. and other developed countries in order to curb greenhouse-gas emissions." (DX 603 at 12.) Later, in the 2013 *Outlook for Energy*, ExxonMobil stated that, when evaluating global energy demand, it set the proxy cost of carbon in developed countries at "about \$80 per ton in 2040 . . . with developing nations gradually following." (JX 912 at 34.) The report included a graphic, reproduced below as Figure 4, that showed the range of proxy cost assumptions ExxonMobil applied globally. (*Id.*) The map indicated that ExxonMobil set its proxy cost of carbon assumption for 2040 (i) below \$20 per ton in regions like Africa and the Middle East; (ii) between \$20 and \$40 per ton in developing economies like Brazil, China, and India; and (iii) above \$40 per ton in developed countries like the United States and Australia.

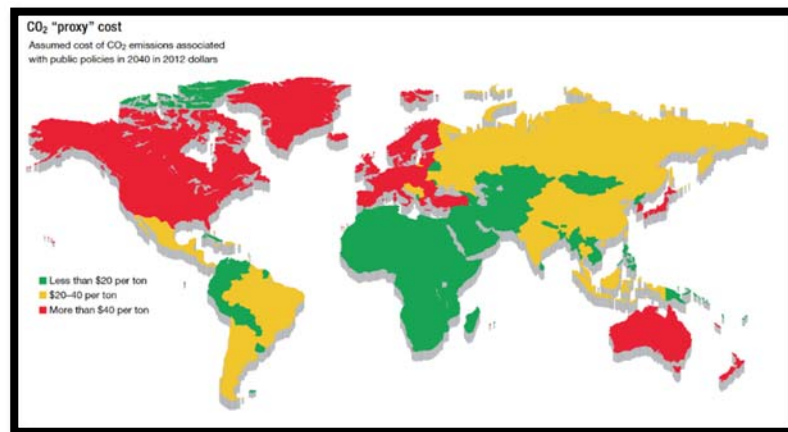


Figure 4: Proxy Cost Map from 2013 *Outlook for Energy*.

Over the years, ExxonMobil consistently explained to the public that it used a proxy cost of carbon to evaluate the impact of climate regulations on energy demand. ExxonMobil did not present its proxy cost assumptions in any greater detail than was contained in the 2013 *Outlook for Energy*.

B. ExxonMobil Made No Disclosures About GHG Costs Until 2013.

ExxonMobil took a different approach to disclosures about its GHG costs that reflected the different purposes of the two assumptions. While the proxy cost of carbon was used to develop information disseminated to the public in an annual publication about global energy markets, GHG costs were used purely for internal purposes—in ExxonMobil’s deliberations about capital investments that it might make. For obvious reasons, those deliberations, and the analyses that supported them, were highly confidential and not shared with the public. (Tillerson Tr. 157:23-158:14; Bailes Tr. 295:2-13.) In keeping with that confidential treatment, ExxonMobil did not make any disclosures until 2013 about its use of GHG costs when considering capital investments. In 2011, for example, ExxonMobil discussed with an investor its proxy cost of carbon for evaluating demand, but declined to discuss the separate question of cost estimates “at a project level” because it was “sensitive information.” (JX 986 at Tab “Engagement 2011-2012.”)

In time, ExxonMobil began to receive inquiries about how it managed climate risks, including those arising from regulatory costs and burdens. Some of those inquiries touched on the role GHG costs play in investment decisions. People wanted to know whether ExxonMobil was taking climate risks into account, and ExxonMobil responded to those inquiries in good faith with accurate information about its efforts.

In 2013, ExxonMobil provided information about its internal planning assumptions to the Carbon Disclosure Project (“CDP”), which compiles and publishes corporate disclosures of environmental risk management. In its submission, ExxonMobil reiterated its use of a proxy cost of carbon as previously disclosed, but also reported in a separate section of the report concerning “Climate Change Risks” that ExxonMobil’s “project evaluation systems consider a cost on greenhouse gas emissions in the OECD.” (JX 985 at 8, 12.)

C. ExxonMobil Made Accurate Statements About GHG Costs in Response to Proposals from Activist Shareholders.

Later in 2013, two groups of activist shareholders filed proposals asking ExxonMobil to explain how it was positioned for future regulations that would limit greenhouse gas emissions. The first group proposed that ExxonMobil report “on the Company’s strategy to address the risk of stranded assets presented by global climate change.” (PX 042 at 2.) The second proposed that ExxonMobil report on “its strategic plans to address climate change and its impacts.” (PX 149 at EMC 000538032.) Both groups clearly stated that they were not asking ExxonMobil to disclose proprietary information. (*Id.*; PX 042 at 2.) In exchange for the withdrawal of these two shareholder proposals, ExxonMobil agreed to publish reports addressing the concerns identified by the activist shareholders. (JX 982 at ARJ_00000023_0001; DX 607 at EMC 000393630.) ExxonMobil published those reports, *Energy and Carbon – Managing the Risks* (the focus of the NYAG’s complaint) and *Energy and Climate*, on March 31, 2014. (PX 001; PX 002.)

Managing the Risks is the first ExxonMobil publication that disclosed ExxonMobil's use of GHG costs to evaluate potential investments. That was by design. In his correspondence with the activist shareholders, David Rosenthal, then ExxonMobil's head of investor relations, stated that ExxonMobil would disclose in *Managing the Risks* "why our proxy cost of carbon is not the only factor we consider in assessing investment opportunities." (JX 982 at ARJ_00000023_0002.) Mr. Rosenthal also memorialized in a five-page document the agreement he reached with the activists on the content of *Managing the Risks*. (DX 607 at EMC 000393595-99.)

The first fifteen pages of *Managing the Risks* address the factors driving global energy demand, the likelihood that governments will enact particular climate policies, and steps ExxonMobil was taking at the time to reduce its own emissions. (PX 001 at 1-16.) After establishing that background, the report pivots to a discussion of ExxonMobil's "Planning Bases and Investments." (*Id.* at 16.) The section begins by alerting the reader that ExxonMobil does "not publish the economic bases upon which [it] evaluate[s] investments due to competitive considerations" and continues with a review of the proxy cost of carbon's influence on ExxonMobil's expectations about future energy demand. (*Id.* at 16-18.) This passage contains the same information ExxonMobil had previously provided in other publications, including the same map that is reproduced above as Figure 4. (*Id.* at 17.)

A new disclosure then appears after the phrase "Perhaps most importantly," which one of the report's authors intentionally inserted as a signpost. (*Id.* at 18.) It reads: "we require that all our business segments include, where appropriate, GHG costs in their economics when seeking funding for capital investments." (*Id.*) That disclosure, which is the centerpiece of the NYAG's case, contained an accurate, concise statement of how ExxonMobil had used its GHG cost assumptions over the previous seven years. GHG costs were used in connection with decisions

about potential capital investments and applied on a case-by-case basis in light of relevant circumstances.

Managing the Risks contains no information about the dollar amounts assigned to GHG costs, how those dollar amounts compare to those assigned to the proxy cost of carbon, or what regions of the world have GHG costs. There are also no statements about the use of GHG costs outside of the context of potential “capital investments” or what factors ExxonMobil uses when determining whether applying GHG costs is “appropriate” in a given case. This description of GHG costs was reviewed and edited in good faith by relevant employees and supervisors striving to ensure that *Managing the Risks* contained a “more precise” description of how ExxonMobil applies “CO2 costs in project evaluations,” as shown below in Figure 5. (DX 637 at EMC 002755117.) Such efforts dispel any suggestion of deceit.

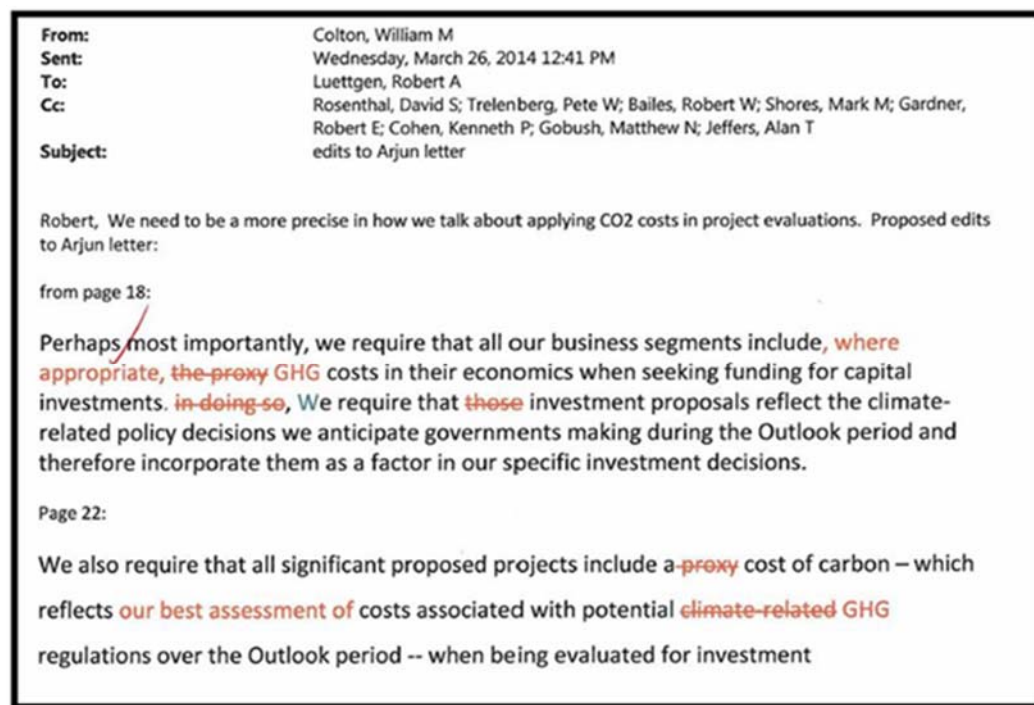


Figure 5: Email revising text to make disclosure “more precise.”

The other report, *Energy and Climate*, contained further information about how the proxy cost of carbon informs the demand outlook and price assumptions ExxonMobil uses in its strategic

planning. As stated in the report, “ExxonMobil’s proxy cost seeks to reflect a reasonable approximation of costs associated with policies that society may impose over time on GHG emissions, policies that we believe would drive society towards increased efficiency and changes to the energy system and its fuel mix.” (PX 002 at 7.) Those shifts in efficiency and fuel mix help inform the oil and gas price assumptions ExxonMobil uses across its business. That is why a later section of the report reads, “ExxonMobil requires that all business units use a consistent corporate planning basis, including the proxy cost of carbon discussed above, in evaluating capital expenditures and developing business plans.” (*Id.* at 20.) The price bases that ExxonMobil sets are influenced by the proxy cost. Investment analyses therefore reflect the impact of both the proxy cost of carbon (through the price bases) and, where appropriate, GHG costs (as an expense item).

ExxonMobil’s stock price did not react in a statistically significant way to the publication of *Managing the Risks* or *Energy and Climate*. (See DX 711 ¶ 15.) Nor was there any stock price reaction to the NYAG’s filing of this lawsuit accusing ExxonMobil of making false statements in those reports. (DX 973 at Ex. 5.) Equity analysts likewise overwhelmingly omitted discussion of these issues in their research reports. (DX 712 ¶¶ 74-75.) Since the NYAG made its allegations, ExxonMobil has continued to describe its use of proxy cost and GHG cost assumptions in materially the same way as in *Managing the Risks* and *Energy and Climate*, most recently in its 2018 *Energy and Carbon Summary*. (JX 917 at 21.) Even the activist shareholders who requested the reports do not claim that ExxonMobil’s proxy cost or GHG cost assumptions were too high or too low, nor do they claim to know what the “right” number is. (Lamb Tr. 138:23-140:20.) Investors wanted to know whether ExxonMobil takes into account risks associated with climate change, and the record indisputably shows that it did.

ARGUMENT

ExxonMobil has made accurate disclosures about its proxy cost of carbon and GHG cost assumptions. Twisting the content of those disclosures, the NYAG alleges that ExxonMobil materially misled the public into believing that it used a single assumption about climate regulations for all purposes and permitted no deviations from the default numbers assigned to that assumption. Based on that flawed theory, the NYAG embarked on a years-long audit of ExxonMobil to search for perceived inconsistencies in purely internal records. It found none, which by itself is fatal to this case. Moreover, no law—certainly no anti-fraud law—authorizes the NYAG to second-guess the good-faith decisions ExxonMobil made about how to apply its assumptions about future climate regulations.

But the NYAG has chosen to bring a fraud case over whether ExxonMobil should have evaluated potential investments in the year 2040 using an assumption of \$80 per ton, \$60 per ton, or some other amount to account for highly uncertain and speculative regulatory costs that no one, including the NYAG, claims to be able to estimate reliably. (*See* DX 781 at 7-9.) The NYAG cannot establish a misleading statement, much less a materially misleading statement as the law requires, on this basis. ExxonMobil's internal assumptions about regulatory costs had no direct impact on ExxonMobil's balance sheet, income statement, or any other financial disclosure, and the NYAG has not alleged that, if its absurd theory is correct, ExxonMobil would be required to restate any of its financial disclosures. No reasonable investor would consider any of this to be material to an investment decision, as shown by the absence of a stock-price reaction and the silence of research analysts. There was no fraud here.

I. ExxonMobil Told the Truth About How It Evaluates Climate Risks.

To prove any of its claims, the NYAG must demonstrate that ExxonMobil made materially misleading representations of existing fact. *See People ex rel. Cuomo v. Charles Schwab & Co.*,

Inc., 2011 WL 5515434, at *7-8 (N.Y. Sup. Ct. N.Y. Cnty. Oct. 24, 2011). “[I]n determining whether a representation is misleading under the securities laws, the test is whether defendants’ representations, taken together and in context, would have misled a reasonable investor about the nature of the investment.” *People ex rel. Schneiderman v. BNY Mellon Corp.*, 2013 WL 4516209, at *11 (N.Y. Sup. Ct. N.Y. Cnty. Aug. 5, 2013) (internal quotation marks and alteration omitted). “Fair accuracy, not perfection, is the appropriate standard” and “nit-picking should not become the name of the game.” *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1200 (2d Cir. 1978). None of ExxonMobil’s statements describing its proxy cost of carbon and GHG costs could have misled a reasonable investor about how ExxonMobil uses these metrics.

A. It Is Undisputed That ExxonMobil Developed and Used Distinct Carbon-Price Assumptions.

The truthfulness of ExxonMobil’s disclosures depends on whether they accurately described ExxonMobil’s practices. There should be no dispute about the relevant practices here. For more than a decade, ExxonMobil has used and continues to use (i) a proxy cost of carbon in its analysis of future energy demand and (ii) GHG costs, where appropriate, in its evaluations of investment opportunities. Reams of evidence bear this out.

Documents and testimony establish ExxonMobil’s recognition that climate regulations could affect its business by reducing demand for its products and by increasing the costs of bringing those products to market. In 2007, separate teams in ExxonMobil’s Corporate Strategic Planning group developed planning assumptions for use in each of those contexts. The team that worked on modeling energy demand developed a proxy cost of carbon assumption that would depress the global demand for sources of energy that generated carbon emissions. (*See* DX 628 at EMC 003203429; Colton Tr. 110:23-111:13, 163:8-164:10.) A separate team developed GHG cost assumptions that could be applied as expense items in evaluations of potential investments

that, if funded, would emit greenhouse gases. (See DX 631 at EMC 002530028-29; Trelenberg Tr. 87:5-89:4; Onderdonk Tr. 568:8-569:2.)

The proxy cost of carbon was used exactly as intended. Demand models over the years show how the proxy cost of carbon depressed ExxonMobil's energy demand projections. (DX 656 at Tab "Res_Comm Demand Reduction.") To the limited extent a direct metric (such as fuel efficiency standards) could be used to suppress demand in a given sector (such as transportation), that metric was used and there was no need to rely on a proxy instead. (JX 925 at EMC 002532516.) Otherwise, the values assigned to the proxy cost of carbon correspond with the disclosures ExxonMobil made about the range of assumptions applied, as reflected in the map reproduced above as Figure 4. The demand assessments that resulted from this exercise were a critical input for selecting the price assumptions (*i.e.*, the price bases) used throughout ExxonMobil for investment evaluations, budgeting, and other purposes. Because they influenced the price bases and the price bases were core assumptions in all planning and budgeting, the proxy cost of carbon influenced financial analysis throughout ExxonMobil. (Powell Tr. 681:7-11; Trelenberg Tr. 327:9-329:13.)

ExxonMobil employees applied GHG costs as intended. Dataguides issued every year starting in 2007 contained default GHG cost assumptions that were disseminated throughout ExxonMobil. Applying those cost assumptions required judgment and consideration of the local regulatory environment, which is why the Dataguide encouraged consultation with subject-matter experts. (DX 623 at 32.) There was no requirement that GHG cost assumptions be uniformly applied in a mindlessly consistent manner. Over time, as global regulatory regimes evolved, the guidance became more detailed, making consultation all the more necessary. In Alberta, Canada, for example, the regulatory regime has been and remains in flux, with rival political factions

enacting and repealing climate regulations regularly. In 2015, the recently elected New Democratic Party amended Alberta's Specified Gas Emitters Regulation ("SGER") to increase the carbon tax imposed on large industrial emitters. (DX 687 at EMC 004060281-82.) At that time, the SGER required large industrial emitters to reduce their emissions below a prescribed threshold or pay a tax on each ton of emissions exceeding that limit. (DX 688 at 8, 15-16.) Employees of ExxonMobil's affiliate Imperial Oil Limited in Alberta applied GHG cost assumptions consistent with the amended SGER. (JX 927 at EMC 001850441-45.) More recently, the political winds have shifted once again in Alberta, and the SGER was replaced by the Carbon Competitiveness Incentive Regulation effective January 1, 2018. (See PX 338 at 1.) In light of local variations such as those in Alberta, GHG cost assumptions were meant to be tailored in an appropriate manner to the situation at hand.

Both the proxy cost of carbon and GHG costs could affect ExxonMobil's consideration of investment opportunities. The oil and gas price bases, influenced by the proxy cost of carbon, determined the projected revenue levels associated with a potential investment. GHG costs, on the other hand, could influence cost projections for a potential investment. Both assumptions could impact a potential capital investment. To an objective observer, none of this should be in dispute in light of the record in this case.

B. ExxonMobil's Public Disclosures Accurately Described the Proxy Cost of Carbon as an Input to Long-Term Projections of Energy Demand.

A reasonable investor reading ExxonMobil's disclosures about the proxy cost of carbon would not have been misled about how ExxonMobil used that assumption in its analysis of future energy demand. ExxonMobil consistently explained that (i) it used proxy costs in formulating its *Outlook for Energy*, and (ii) the *Outlook for Energy* reflected ExxonMobil's long-term view of energy supply and demand. Investors were familiar with this latter point as early as 2006. In that

year's *Outlook for Energy*, ExxonMobil explained that "long-term planning is critical," which is "why each year ExxonMobil prepares a detailed long-term energy supply and demand outlook." (DX 601 at EMC 004072436.) In its 2013 *Outlook for Energy*, ExxonMobil further explained it "assumes a cost of carbon as a proxy for a wide variety of potential policies that might be adopted by governments over time to help stem GHG emissions such as carbon emissions standards, renewable portfolio standards and others." (JX 912 at 34 (emphasis added).) ExxonMobil observed that "these policies are likely to have a direct and significant impact on the fuel choices made by individual countries." (*Id.*) Thus, as disclosed, the proxy cost of carbon reflected a wide range of climate policies that could impact energy demand in the broader economy.

At every turn, ExxonMobil emphasized that it used the proxy cost of carbon to consider how a wide range of climate regulations might affect the long-term demand for energy reported in the *Outlook for Energy*. In its 2009 Corporate Citizenship Report, for example, ExxonMobil explained that it "test[s] a range of potential costs for energy-related GHG emissions in [its] *long-term Outlook for Energy*, which is used for assessing the business environment and in our investment evaluations." (DX 780 at 34 (emphasis added).) Likewise, in its 2010 annual report, ExxonMobil noted that it "includes estimates of potential costs related to possible public policies covering energy-related greenhouse gas emissions *in its long-term Energy Outlook*." (JX 901 at 49 (emphasis added).)

The 2014 reports that ExxonMobil prepared in response to proposals from activist shareholders are entirely consistent with the disclosures described above. In *Managing the Risks*, ExxonMobil explained that the proxy cost of carbon is "embedded in our current Outlook for Energy, and has been a feature of the report for several years." (PX 001 at 17.) The report continued, "[t]he proxy cost seeks to reflect all types of actions and policies that governments may

take over the Outlook period relating to the exploration, development, production, transportation or use of carbon-based fuels.” (*Id.*) *Energy and Climate* reiterated the connection between the proxy cost of carbon and the *Outlook for Energy* and the wide range of climate regulations encompassed by the proxy cost. It stated, “for our Outlook[,] we use a cost of carbon as a proxy to model a wide variety of potential policies that might be adopted by governments to help stem GHG emissions.” (PX 002 at 5-6.) The report went on to explain that the policies reflected in the proxy cost of carbon will likely “accelerate the growth of lower carbon sources of energy like natural gas and renewables, while suppressing the global use of coal.” (*Id.* at 6-7.) None of these disclosures would have misled a reasonable investor about how ExxonMobil used the proxy cost of carbon assumption.

C. ExxonMobil’s Public Disclosures Accurately Described GHG Costs as Project-Specific Assumptions Applied Where Appropriate.

Before 2013, ExxonMobil made no public statements about its GHG costs. But beginning in 2013, ExxonMobil’s public disclosures established that GHG cost assumptions were applied, where appropriate, to account for the cost of emissions in the economic evaluation of specific projects. In its 2013 CDP submission, for example, ExxonMobil disclosed for the first time that its “project evaluation systems consider a cost on greenhouse gas emissions in the OECD[,] which can lend support to *some* of these projects.” (JX 985 at 12 (emphasis added).) In other words, ExxonMobil applies these assumptions as a direct expense of emissions, and that some—but not all—projects could benefit from this long-term strategic planning. This submission was entirely consistent with ExxonMobil’s internal practices. (*E.g.*, JX 921 at 31 (providing default GHG cost assumptions for OECD countries in 2013).) As ExxonMobil’s former Greenhouse Gas Manager explained, GHG cost assumptions in the Dataguide were intended “to provide the business units

with [g]uidance on which cost[s] they are reasonably likely to incur directly to business operations for those jurisdictions that have been identified.” (Powell Tr. 176:8-13.)

When ExxonMobil elaborated on GHG costs in *Managing the Risks*, it again emphasized the context-dependent nature of these planning assumptions. “Perhaps most importantly,” the report clarified, “we require that all our business segments include, *where appropriate*, GHG costs in their economics when seeking funding for capital investments.” (PX 001 at 18 (emphasis added).) *Managing the Risks* made clear that GHG cost assumptions are not applied in each and every case, but as appropriate to account for the cost of emissions attributable to specific projects. ExxonMobil’s internal practices again affirm this understanding. For example, in 2011, the Dataguide specified a default GHG cost assumption of \$20 per ton beginning in 2015 for OECD areas outside the European Union. (*See* DX 618 at 35.) The default GHG cost assumption then tracked the European Union’s emissions trading scheme beginning in 2020, “rising linearly” to \$40 per ton in 2030. (*Id.*) An economic evaluation in Alberta, Canada applied these GHG cost assumptions as specified by the Dataguide. (JX 941 at Tab “Mine and Extraction.”) Another project, however, received permission to omit GHG cost assumptions because it had already accounted for the expense of emissions through an environmental permitting process. (DX 645 at EMC 003180006-09.) Thus, consistent with its representations, ExxonMobil applied GHG cost assumptions on a case-by-case basis in light of relevant circumstances.

D. No Reasonable Investor Would Have Been Misled by ExxonMobil’s Disclosures About Its Proxy Cost of Carbon and GHG Cost Assumptions.

The NYAG alleges that ExxonMobil’s disclosures would have caused a reasonable investor to believe that (i) ExxonMobil used a single carbon price assumption for all purposes, (ii) the values assigned to that assumption correspond with those contained in the map reproduced above (as Figure 4) and reached \$80 per ton in OECD countries by 2040, and (iii) deviation from

the mechanical application of these values was strictly prohibited. (Compl. ¶¶ 94, 84, 87, 122.) The NYAG's expert witnesses dutifully promote the NYAG's theory, going so far as to independently coin a term ("GHG Emissions Proxy Costs") to cover them both. (Boukouzis Tr. 67:19-23; Bartov Tr. 90:12-13, 94:17-95:7, 103:11.) But this bolstering by experts and reliance on clever labels neither transforms these two distinct metrics into a unitary concept, nor salvages the NYAG's case.

ExxonMobil did not mislead investors into believing it used a single assumption about future climate regulations for all purposes. ExxonMobil's disclosures certainly never said so. In *Managing the Risks*, ExxonMobil explicitly referred to its proxy cost of carbon as a factor in its "rigorous analyses of supply and demand" in the *Outlook for Energy* process. (PX 001 at 3, 17.) "Perhaps most importantly," the report transitioned, ExxonMobil requires that all of its "business segments include, where appropriate, GHG costs in their economics *when seeking funding for capital investments*." (*Id.* at 18 (emphasis added).) ExxonMobil's disclosures identified two metrics—a proxy cost of carbon, and GHG costs—and identified the different context in which they are used. ExxonMobil never said they were the same metric. Moreover, ExxonMobil identified only two contexts in which assumptions about future climate regulations might be considered: demand modeling and capital investments. Any belief that the assumptions necessarily applied to other contexts cannot be attributed to anything ExxonMobil said.

ExxonMobil did not mislead investors into believing that the proxy cost of carbon and GHG costs were set at the same levels. None of ExxonMobil's disclosures said that, and none of its disclosures suggested as much. In *Energy and Climate*, ExxonMobil stated unambiguously that it applies "*a proxy cost that is about \$80 per ton in 2040*" in OECD countries. (PX 002 at 6 (emphasis added).) Likewise, *Managing the Risks* repeated that "[o]ur *proxy cost . . . in some*

areas may approach \$80/ton over the Outlook period.” (PX 001 at 17-18 (emphasis added).) While ExxonMobil made limited disclosures about the range of values assigned to the proxy cost of carbon throughout the world and over time, it expressly declined to disclose assumptions, such as GHG costs, that are used directly to evaluate potential investments.

And ExxonMobil did not mislead investors into believing that there could be no deviation from the default GHG cost assumptions. Nowhere in any of ExxonMobil’s disclosures does it say that GHG costs are strictly applied in all circumstances without deviation. To the contrary, the relevant disclosures alert investors that the assumptions are speculative and applied using ExxonMobil’s best judgment. ExxonMobil made clear that it applied GHG costs only “where appropriate,” which presupposes there are situations where applying them is not appropriate. (*Id.* at 18.) This “adequate cautionary language” would not “mislead a reasonable investor about the nature of the securities offered.” *In re Netshoes Sec. Litig.*, 64 Misc. 3d 926, 936 (N.Y. Sup. Ct. N.Y. Cnty. 2019) (internal quotation marks omitted).

Rather than seeking to prove that ExxonMobil’s disclosures are misleading, the NYAG appears to have settled for witnesses willing to say only that they were unclear about what the disclosures meant. For example, Natasha Lamb, who represented one of the activist shareholders (but was not an investor herself), testified that she was confused about the difference between the proxy cost of carbon and GHG cost assumptions (but admitted that she did not make any use of those assumptions in any investment decision). (Lamb Tr. 68:6-7, 133:11-14.) The NYAG also complains that including a discussion of the proxy cost of carbon and GHG costs in the same paragraph of *Managing the Risks* was likely confusing to investors. (Compl. ¶ 94.) But even “where the quality of a disclosure could have been improved, the advisability of revision does not render what was done deceptive or misleading.” *In re ProShares Trust Sec. Litig.*, 728 F.3d 96,

109 (2d Cir. 2013) (quoting *Greenapple v. Detroit Edison Co.*, 618 F.2d 198, 207, 210-11 (2d Cir. 1980)). The NYAG cannot substitute claims of confusion by activist shareholders for evidence that the disclosures at issue tended to mislead a reasonable investor.

E. ExxonMobil Had No Reason to Make Misleading Disclosures About Its Proxy Cost of Carbon and GHG Cost Assumptions.

ExxonMobil had no reason to deceive the public about its use of the proxy cost of carbon and GHG costs. No law or regulation required the use of carbon prices, and ExxonMobil's competitors had made minimal, if any, disclosures about their carbon assumptions. Indeed, State Street Global Advisors observed that "most companies in the [United States] do not disclose their carbon price assumptions." (PX 122 at 42.) ExxonMobil therefore was under no pressure to match the disclosures its competitors made by exaggerating the ways it addressed climate risk.

Nor did ExxonMobil need to put on "a facade to deceive investors," as the NYAG alleges. (DX-709 at 1-2.) The difference between the assumptions used in demand modeling and in project evaluation dates back to the inception of the metrics in 2007, and there were good reasons for the difference. Proxy cost assumptions were generally higher than those assigned to GHG costs because they captured the cost of all climate policies, whether borne by producers or consumers. GHG costs, on the other hand, were designed to capture only the subset of climate regulatory costs that were borne by producers. Even the NYAG's expert witness testified that he saw no reason why the assumptions used to model energy demand could not differ from assumptions used to project expenses associated with future regulatory policies. (Boukouzis Tr. 107:2-25.) ExxonMobil had no reason to conceal the difference.

More fundamentally, ExxonMobil has no incentive to deceive itself about the potential returns of contemplated investments. The NYAG claims that, when evaluating potential investments, ExxonMobil should have used the higher assumptions associated with the proxy cost

of carbon (at least until the assumptions were aligned in June 2014 for OECD countries) and should never have deviated from the default assumptions. (Compl. ¶ 123.) Any deviation, in the NYAG’s hyperbolic view, amounts to “a Potemkin village to create the illusion that [ExxonMobil] had fully considered the risks of future climate change regulation.” (Compl. ¶ 19.) Unlike a Potemkin village, the very purpose of which is to deceive onlookers, the analysis that the NYAG criticizes here was purely internal. It was never shown to a single outside investor. The analysis was used to evaluate potential capital investments in an industry with assets having decades-long lifespans and requiring substantial capital outlays. In this context, ExxonMobil had every incentive to use the most accurate planning assumptions possible. Underestimating potential climate regulatory costs would only set up a potential investment to underperform—an outcome that would serve neither ExxonMobil nor its shareholders. The only Potemkin village here is the one constructed by the NYAG’s meritless allegations.

II. The Challenged Statements Were Not Material to Reasonable Investors.

The NYAG must also prove materiality to prevail on any of its claims.² New York has adopted the federal standard of materiality in securities fraud cases. *See Rachmani*, 71 N.Y.2d at 726. Under that standard, “[a] statement or omission is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to act.” *IBEW Local Union No. 58 v. RBS*, 783 F.3d 383, 389 (2d Cir. 2015) (internal quotation marks omitted). In other words, courts must determine “whether the misstatement significantly altered the ‘total mix’ of information available to investors.” *ECA, Local 134 IBEW Joint Pension Tr. of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009). An event study showing whether the

² See *State v. Rachmani Corp.*, 71 N.Y.2d 718, 726 (1988) (Martin Act, Gen. Bus. Law §§ 352-53 and Executive Law § 63(12)); *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 559 (2009) (actual fraud); *People v. Credit Suisse Sec. (USA) LLC*, 31 N.Y.3d 622, 641 (2018) (Feinman, J., concurring) (equitable fraud).

disclosure of a company's alleged fraud had an impact on that company's stock price is well-recognized as the leading method to establish materiality in an efficient securities market. *See Oran v. Stafford*, 226 F.3d 275, 282 (3d Cir. 2000). The evidence in this case shows that none of the challenged disclosures are material.

A. The Challenged Disclosures Were Immaterial as a Matter of Law.

The NYAG challenges disclosures that cannot meet the applicable standard of materiality. An alleged misstatement is material to a reasonable investor only if it is "sufficiently specific" to "guarantee . . . some concrete fact or outcome." *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 185 (2d Cir. 2014). Disclosures containing "open-ended and subjective" language are not material because a reasonable investor would not make an investment decision based on conjecture. *Id.* at 186. Mere "generalizations" about a company's business practices cannot amount to material representations. *See ECA & Local 134 IBEW Pension Tr. of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 206 (2d Cir. 2009).

Take, for example, the Second Circuit's decision in *Carpenters Pension Tr. Fund of St. Louis v. Barclays PLC*, 750 F.3d 227 (2d Cir. 2014). There, the defendant told the public that "minimum control requirements had been established for all key areas of identified risk," despite lacking internal controls for certain projects. *Id.* at 236. The Second Circuit held the defendant's generalizations were not specific enough to be material to investors. *See id.*; *see also JP Morgan Chase Co.*, 553 F.3d at 206. Unless a firm makes specific assertions about discrete topics, general statements about its business operations are simply not material. Such statements are "so obviously unimportant" that no reasonable investor would consider them "important in deciding how to act." *In re JPMorgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 625-26 (S.D.N.Y. 2005) (internal quotations omitted).

The disclosures at issue here are far too contingent and insufficiently specific to form a material part of an investment decision. At the core of the NYAG's case is ExxonMobil's disclosure in *Managing the Risks* that "all our business segments include, where appropriate, GHG costs in their economics when seeking funding for capital investments." (PX 001 at 18.) That disclosure falls well short of the "sufficiently specific" standard for establishing materiality. Investors reading that disclosure, along with the rest of *Managing the Risks*, would have no ability to predict when ExxonMobil would consider it "appropriate" to apply GHG costs to its internal evaluation of investment opportunities. They would have no insight into the criteria ExxonMobil used to gauge "appropriateness" or how that criteria was applied. Investors simply had no "guarantee . . . [of] some concrete fact or outcome" in connection with the application of GHG costs based on ExxonMobil's disclosures. *City of Pontiac*, 752 F.3d at 185. ExxonMobil did not promise a particular outcome in every instance and made no assertions about specific projects.

Just this year, the Second Circuit held that "tentative and generic" statements that "emphasize the complex, evolving regulatory environment" faced by a corporation cannot be material. *Singh v. Cigna Corp.*, 918 F.3d 57, 64 (2d Cir. 2019). Here, ExxonMobil's disclosures repeatedly emphasized the uncertain nature of climate regulations. *Managing the Risks* stated that the proxy cost of carbon addresses "the *potential* for *future* climate-related controls" and "reflect[s] all types of actions and policies that governments *may* take over the Outlook period," which extends out to 2040. (PX 001 at 17 (emphasis added).) *Energy and Climate* likewise stated that "[f]uture policies related to limiting GHG emissions *remain uncertain* and likely will vary over time and from country to country." (PX 002 at 5 (emphasis added).) These statements, "framed by acknowledgements of the complexity and numerosity of applicable regulations," strongly suggest "caution (rather than confidence)." *Singh*, 918 F.3d at 64. No reasonable investor would

have viewed speculative assumptions about hypothetical regulatory costs projected decades into the future as “significantly alter[ing] the total mix of information made available.” *Id.*

B. ExxonMobil’s Stock Price Did Not React to ExxonMobil’s Disclosures or to the NYAG’s Purported Corrective Disclosures.

The parties agree that the market for ExxonMobil securities is efficient. Accordingly, any material information released to the market should be reflected in its stock price. *See Oran*, 226 F.3d at 282. To the extent information is not important to reasonable investors, “it follows that its release will have a negligible effect on the stock price.” *In re Burlington*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.). Thus, a fraudulent statement can be expected to drive up a stock price, which will then fall when the fraud is uncovered. The NYAG attempts to show stock price movement with a flawed event study that fails to establish materiality.

Dr. Eli Bartov, one of the NYAG’s expert witnesses, asserts an inflationary period in ExxonMobil’s stock price beginning on April 1, 2014, the day after ExxonMobil released *Managing the Risks* and *Energy and Climate*. (See JX 973 ¶ 57.) Under his reasoning, ExxonMobil’s disclosures in those reports about the proxy cost of carbon and GHG costs caused investors to adopt a favorable view of ExxonMobil and bid up the stock. (*Id.* ¶ 52.) That theory is contradicted by the evidence, which shows no indication of any price inflation. Indeed, ExxonMobil’s stock price experienced no statistically significant movement after the publication of the shareholder reports. (See DX 711 ¶ 15; Bartov Tr. 326:25-327:2.) Any purported inflationary period is therefore illusory.

Dr. Bartov’s purported corrective disclosures are equally unsupported by evidence. A corrective disclosure “is an announcement or series of announcements that reveals to the market the falsity of a prior statement.” *Arkansas Teachers Ret. Sys. v. Goldman Sachs Group, Inc.*, 879 F.3d 474, 480 n.3 (2d Cir. 2018). It might be expected that the NYAG would come forward with

ExxonMobil's statements that allegedly contradicted or revised earlier statements. But there is no evidence of any such correction here. ExxonMobil stands behind the disclosures challenged in this case. Without any corrective disclosures from ExxonMobil, the NYAG is forced to claim that its own accusations and the existence of investigations by other regulators constitute corrective disclosures. There is no merit in that assertion.

It is notable that the NYAG does not allege that either the disclosure of its own investigation or the filing of its complaint in this action constitutes a corrective disclosure. The NYAG concedes that there was no statistically significant stock price movement when it launched its investigation, held a press conference about its investigation, or commenced the present lawsuit. (JX 973 at Ex. 5.) Instead, Dr. Bartov identified three purported corrective disclosures that had more to do with identifying dates where ExxonMobil's stock price moved than statements that actually responded to the disclosures at issue here.³

Dr. Bartov claims that news reports of an SEC investigation on September 20, 2016, and hyperbolic allegations the NYAG made in a court filing on June 2, 2017, are corrective disclosures. (JX 973 ¶¶ 64, 67-68.) Yet neither of those purported disclosures corresponds with a decline in ExxonMobil's stock price that is significant at the five-percent level, which Dr. Bartov recognizes as the accepted standard for statistical significance. (*Id.* ¶ 61; Bartov Tr. 375:11-17.) That alone is sufficient reason to disqualify these two candidates from consideration as corrective disclosures. But it is not the only reason. Neither of these events conveyed new information to the market. The news story about the SEC investigation placed it within the context of other investigations that had been pending for months and did not suggest the SEC was breaking new ground. (JX 973

³ Deficiencies in Dr. Bartov's report are described in further detail in the brief ExxonMobil filed in support of its motion *in limine* to exclude Dr. Bartov's testimony. See NYSCEF Dkt. 360, Def.'s Mem. of Law in Supp. of its Mot. *in Limine* to Exclude the Proposed Test. of Eli Bartov at 16-22 (Oct. 4, 2019).

¶ 67; DX 698.) Moreover, the announcement of a government investigation, “without more, is insufficient to constitute a corrective disclosure.” *See Meyer v. Greene*, 710 F.3d 1189, 1201 (11th Cir. 2013). That is because the announcement may have a “*negative* effect on stock prices, but not a *corrective* effect.” *In re Initial Pub. Offering Sec. Litig.*, 399 F. Supp. 2d 261, 266 (S.D.N.Y. 2005). That is particularly true when an investigation is subsequently closed without any charges being filed, *see Meyer*, 710 F.3d at 1201, as the SEC did here with respect to ExxonMobil. (See DX 702.) Likewise, the NYAG’s June 2017 allegations were simply the latest in a string of hyperbolic statements the NYAG had made about its investigation of ExxonMobil, all of which is familiar to this Court. (JX 973 ¶ 68.) Both events were just more of the same.

The NYAG’s third corrective disclosure is contained in news reports on January 20, 2016 about the California Attorney General’s investigation of ExxonMobil. This purported corrective disclosure is statistically significant at the five-percent level only by using a full-day event window, rather than the narrower “close-to-open” event window that is appropriate when evaluating disclosures released prior to the market open for large, heavily traded securities like ExxonMobil’s. (DX 711 ¶¶ 28-32.) When evaluated under the appropriate window, there is no statistically significant price impact. (*Id.*)

Moreover, even if the Court were to accept Dr. Bartov’s flawed event window, reports about the California Attorney General’s investigation cannot qualify as a corrective disclosure because they contained no new information about the disclosures at issue here. Reporting on the California Attorney General’s investigation indicated that her investigation covered the same ground as the NYAG’s investigation. The *Los Angeles Times* reported that the California Attorney General was investigating whether ExxonMobil “*lied to the public* and its shareholders about *the risk to its business from climate change*.” (JX 970 at 2 (emphasis added).) But just a few months

earlier, on November 5, 2015, the *New York Times* had already reported that the NYAG was investigating “whether the company *lied to the public about the risks of climate change or to investors about how such risks might hurt the oil business.*” (DX 695 at 1 (emphasis added).) This purportedly corrective disclosure therefore did nothing more than report information already known to the market. The repeated disclosure of known information would not have any impact on ExxonMobil’s stock price.

C. ExxonMobil’s Disclosures About the Proxy Cost of Carbon and GHG Costs Were Not Important to Equity Research Analysts.

Equity analysts who covered ExxonMobil barely noticed ExxonMobil’s disclosures about the proxy cost of carbon and GHG costs. Dr. Marc Zenner, one of ExxonMobil’s expert witnesses, identified close to 500 equity analyst reports about ExxonMobil published between 2014 and 2017. (DX 712 ¶ 66.) Only six percent even contained one of a handful of climate-related keywords, such as “emissions,” “greenhouse,” and “climate change,” and virtually none discuss climate risk in any meaningful detail. (*See id.*) Dr. Zenner also examined 25 analyst reports covering ExxonMobil, which were issued during the two weeks following the filing of NYAG’s Complaint. (*Id.* ¶ 74.) None of the reports Dr. Zenner examined “specifically discussed the proxy cost of carbon or GHG costs or even mentioned the Complaint at all.” (*Id.* ¶ 75.) The NYAG’s experts do not dispute this compelling evidence. At the end of the day, the market simply was not concerned with ExxonMobil’s use of these assumption.

The NYAG’s expert, Peter Boukouzis, failed to identify a single analyst who changed his or her rating of ExxonMobil based on its proxy cost and GHG cost disclosures. He conceded as much at his deposition, stating that he did not “know if [he] saw a specific upgrade or downgrade on the disclosures over the last ten years specifically.” (Boukouzis Tr. 221:8-10.) Mr. Boukouzis identified just a single analyst who *mentioned* climate risk in connection with ExxonMobil’s

valuation. (JX 972 ¶¶ 85-86.) And, in that case, the analyst declined to change his buy/sell recommendation and acknowledged that the challenge to ExxonMobil stemmed from the “headline risks” associated with the since-closed SEC investigation—not the truth of any underlying allegations. (JX 977.) The NYAG cannot establish that ExxonMobil’s disclosures related to the proxy cost of carbon and GHG costs were material to equity analysts, much less, actual investors.

D. The NYAG’s Adjustment to ExxonMobil’s Internal Evaluations of Potential Investments Would Not Have Altered Any Investment Decisions.

The NYAG attempts to establish materiality through expert analysis replacing the GHG cost assumptions ExxonMobil used in investment evaluations with values assigned to the proxy cost of carbon. No investor would have been able to perform this analysis because, as ExxonMobil explained in *Managing the Risks*, ExxonMobil does “not publish the economic bases upon which [it] evaluate[s] investments due to competitive considerations.” (PX 001 at 16.) No investors had any insight into the evaluations ExxonMobil performed of potential investments, and no investor could have made an investment decision based on any assumption contained in those evaluations. Any purported deviations in applying assumptions in internal investment evaluations could not have altered the total mix of information available to the public.

The NYAG’s expert witness, Peter Boukouzis, fails to prove otherwise. His analysis amounts to selecting a motley sample of 27 internal economic models and replacing the GHG cost assumptions in those models with undisclosed proxy cost of carbon assumptions.⁴ (JX 972 ¶¶ 120-21.) Mr. Boukouzis uniformly applies proxy cost assumptions to 100 percent of emissions, even in five models for which ExxonMobil determined that only a fraction of emissions would be taxed under local regulations. (*Id.* ¶ 122.) Mr. Boukouzis then concludes that, leaving “[a]ll other input

⁴ Deficiencies in Mr. Boukouzis’s report are described in further detail in the brief ExxonMobil filed in support of its motion *in limine* to exclude Mr. Boukouzis’s testimony. See NYSCEF Dkt. 353, Def.’s Mem. of Law in Supp. of its Mot. *In Limine* to Exclude the Proposed Test. of Peter Boukouzis at 17-21 (Oct. 4, 2019).

parameters in the models . . . unchanged,” his adjustments reduce certain financial metrics for these projects. (*Id.* ¶ 121.) According to Mr. Boukouzis, these reduced financial metrics would have altered senior management’s decisions and communications to investors. (*Id.* ¶¶ 126-29.)

Mr. Boukouzis’s analysis is fundamentally flawed. First, he fails to establish that ExxonMobil even considered the models he manipulated when making investment decisions. In fact, of the 27 economic models Mr. Boukouzis reviewed, he admitted that at least 19 were not “investment decision models.” (JX 972 ¶ 125 & n.282.) At his deposition, Mr. Boukouzis conceded he had “no way of knowing” whether a model he adjusted was merely a “draft model” or an “exploratory internal working model”; or “if any of these were actually funded projects”; or “where exactly these models went within ExxonMobil”; and, critically, whether any of these models was presented to senior management at ExxonMobil. (Boukouzis Tr. 259:20-260:13, 266:12-18, 271:15-272:2.)

Second, Mr. Boukouzis offers no basis to suggest that senior management would have made different business decisions based on his adjustments. During his deposition, Mr. Boukouzis admitted that he did not even “know what was communicate[d] to [senior management] about any of the projects that [he] modified,” or whether senior management even reviews the “financial metrics” he analyzed. (*Id.* at 345:18-24, 346:19-22.) Moreover, Mr. Boukouzis fails to establish that his adjustments would render any project unprofitable. Key financial metrics that were positive before his adjustments remained positive even after his adjustments. (*See* JX 972 at Ex. 11.) As ExxonMobil’s expert witness, Dr. Marc Zenner, explained, “the Boukouzis Report itself demonstrates that no financial decisions regarding project viability based on [net present value] would have been affected by Mr. Boukouzis’ model adjustments.” (DX 712 ¶ 99.) As speculative

planning assumptions applied to potential investments, the proxy cost of carbon and GHG cost assumptions did not have any impact on ExxonMobil's bottom line.

Third, Mr. Boukouzis cannot demonstrate how ExxonMobil would have “presented less optimistic business projections” to the investing public had its models reflected Mr. Boukouzis's adjustments. (DX 972 ¶ 22.) At his deposition, he could not point to any communications from ExxonMobil to investors that would have been different if ExxonMobil had applied its proxy cost of carbon assumptions in economic models rather than GHG costs. (Boukouzis Tr. 344:6-345:17.) He also admitted that the models themselves, along with their inputs and outputs, were proprietary and never publicly disclosed. (*Id.* at 201:13-202:10, 204:20-205:3; *see also* DX 712 ¶ 102.) Because ExxonMobil's proxy cost and GHG cost schedules were never disclosed, any purported deviations in applying these planning assumptions could not have altered the total mix of information made available to investors.

Finally, Mr. Boukouzis claims, without support, that ExxonMobil's application of GHG costs rather than proxy costs in internal economic models “would have likely positively biased [the] Investment Community's assessments and valuations of ExxonMobil.” (DX 972 ¶ 22.) Even if investors were somehow conveyed the granular financial information contained in these models—and they were not—Mr. Boukouzis identifies no evidence that such information would have altered investors' valuation of ExxonMobil. For example, he does not point to a single report by equity analysts that discusses such information, or indicates it was important to valuation analyses. Accordingly, Mr. Boukouzis's baseless manipulation of ExxonMobil's internal models would not have “assumed actual significance in the deliberations of the reasonable shareholders.” *Rachmani*, 71 N.Y.2d at 726.

E. The NYAG Cannot Establish Materiality Through Its Allegations About ExxonMobil's Impairment Disclosures.

The NYAG alleges that ExxonMobil did not take impairments when required by GAAP. (Compl. ¶¶ 225, 236.) After a four-year review of ExxonMobil's impairment disclosures, the NYAG and its expert identified a single asset, Mobile Bay (an aging, non-core asset ExxonMobil recently sold), that the NYAG says should have been impaired in 2015. (JX 973 ¶ 17.) The NYAG's expert makes no claims about any other asset or any other year. In the NYAG's view, GHG cost assumptions should have been applied to ExxonMobil's impairment assessment of Mobile Bay in 2015, and if those assumption had been applied there would have been an impairment. (Compl. ¶ 254.) The NYAG is wrong on multiple levels.

GAAP establishes a three-step approach to asset impairments. First, a company must determine whether an impairment "trigger" exists for a given asset. (Compl. ¶ 228; JX 968 at ASC 360-10-35-21.) Absent a trigger, a company need not conduct any further analysis. Second, if a trigger exists, a company must assess whether an asset's current book value can be recovered through its future undiscounted cash flows. (*Id.* at ASC 360-10-35-17.) The accounting standards require that the impairment cash flow models created at this step use assumptions that are "reasonable in relation to" those a company uses in other aspects of its business planning. (*Id.* at ASC 360-10-35-30.) Third, if the impairment cash flow analysis reveals that an asset's book value cannot be recovered through future cash flows, ExxonMobil must calculate the asset's fair value so it can determine the size of the required impairment. (*Id.* at ASC 360-10-35-17.)

ExxonMobil's impairment disclosures and accounting practices in 2015 were fully consistent with GAAP. As reported in ExxonMobil's 2015 annual report, "If there were a trigger event," ExxonMobil's assessment of whether future cash flows covered an asset's carrying value would "make use of the Corporation's price, margin, volume, and cost assumptions developed in

the annual planning and budgeting process, and are consistent with the criteria management uses to evaluate investment opportunities.” (JX 906 at 70.) This disclosure pertained expressly to the analysis GAAP requires at step two of its three-step process.

ExxonMobil never reached step two in its 2015 impairment analysis, however, because it determined that no trigger event had occurred. ExxonMobil’s independent auditor, PricewaterhouseCoopers (“PwC”), contemporaneously confirmed that ExxonMobil was not required to reach step two, concluding that there was no impairment triggering event for the Mobile Bay asset. (DX 670 at 11.) As a result, ExxonMobil’s statements about what would happen at step two of impairment testing were inapplicable to the step one impairment testing ExxonMobil actually performed in 2015.

Even if ExxonMobil had reached step two in 2015, it would not have necessarily applied GHG cost assumptions to its impairment testing in the manner the NYAG alleges. Nowhere in its 2015 annual report did ExxonMobil affirmatively represent that it would include GHG costs in impairment evaluations. It stated instead that, at step two, its impairment evaluations “make use of . . . cost assumptions” that are “consistent with” criteria used to assess potential investments. (JX 906 at 70.) In this way, ExxonMobil reiterated the principle embedded within the relevant accounting standard that assumptions used in impairment assessments must be “reasonable in relation to” those used in business planning. (JX 968 at ASC 360-10-35-30.) In adopting a reasonableness standard, the drafters of that standard recognized the crucial role of judgment in deciding what assumptions to include in impairment assessments. This is especially true where “there is significant uncertainty associated with the amount and/or timing of the estimates.” (DX 713 ¶ 58.)

In addition, as a U.S. asset located in the Gulf of Mexico, Mobile Bay was not subject to regulatory costs associated with reducing greenhouse gas emissions in 2015, is not now, and whether it will ever bear any GHG costs during its remaining life remains uncertain. This uncertainty about the application of potential costs of climate regulations in jurisdictions like the United States factored into decision-making about impairments. As ExxonMobil's independent auditor observed, GHG costs "represent[] a speculative cost, rather than a known or likely cost." (DX 672 at 7.) Recognizing that GAAP "generally require[s] the consideration of enacted laws," the auditor concluded that GHG costs were too speculative and should not be included in impairment testing. (*Id.*) It is therefore at least an open question whether ExxonMobil's independent auditor would have even allowed ExxonMobil to record an impairment in 2015 had it included GHG costs in its analysis.

The NYAG's expert claims that including GHG costs at step two in 2015 would have caused Mobile Bay's carrying value to exceed its future cash flows by \$19 million, thereby indicating a potential impairment. (JX 973 ¶¶ 38, 48.) To reach that conclusion, the NYAG's expert ignores that the relevant cash-flow model for Mobile Bay omitted certain revenue streams and overstated certain expense items in 2015. (Higgins Tr. 243:23-244:3, 152:10-17.) Adjusting the 2015 model to correct for the understated revenue and overstated expenses yields an additional \$250 million in revenue, which is significantly in excess of the \$74 million in "GHG Emission Proxy Costs" the NYAG claims should have been applied in 2015. (*Compare* Higgins Tr. 156:24-157:4, *with* JX 973 ¶ 48.) This explains why, in 2016, when ExxonMobil adjusted the model to include the omitted revenue and eliminate the overstated expenses, Mobile Bay was recoverable to the tune of \$110 million, even though GHG costs were included in that cash-flow model. (DX

713 ¶ 21.) At the end of the day, Mobile Bay would not have been impaired in 2015, even if the cash flow model had included GHG costs.

Even accepting NYAG's allegations as true, the purported \$478 million impairment of Mobile Bay would have represented less than three percent of ExxonMobil's earnings in 2015. (*See* JX 906 at 79.) This figure was also well below PwC's auditing threshold for performance materiality of \$1.5 billion in 2015. (DX 670 at 3.) And Mobile Bay's net book value of \$1.28 billion represented only 0.4 percent of ExxonMobil's total assets in 2015. (*Compare* DX 713 at Ex. 1, *with* JX 906 at 30.) Not even the NYAG's expert offered an opinion that the purported impairment would have been material. ExxonMobil's alleged failure to impair Mobile Bay, even if true—which it was not—would be totally immaterial to ExxonMobil's bottom line and to any reasonable investor's decision to buy or sell the stock.

III. The NYAG Cannot Establish This Court's Jurisdiction Over ExxonMobil.

The NYAG's allegations of fraud arise from two key disclosures made in Texas and outside the boundaries of New York State. Under well-settled precedent, state courts lack constitutional jurisdiction over foreign corporations where the conduct at issue is based on “random, fortuitous, or attenuated contacts” with the forum state. *See Williams v. Beemiller*, 159 A.D.3d 148, 157 (4th Dep't 2018) (quoting *Walden v. Fiore*, 571 U.S. 277, 286 (2014)), *aff'd*, 33 N.Y.3d 523 (2019). Not only has the NYAG charged a fraud that is devoid of merit or proof, it has failed to carry its burden of showing that its claims have the requisite nexus to the State of New York and are properly before a New York court. This jurisdictional defect provides a further basis to reject the NYAG's claims and enter a judgment for ExxonMobil.

CONCLUSION

The NYAG brought a case against ExxonMobil that ignores the evidence and implicates what Justice Robert H. Jackson called “the greatest danger of abuse of prosecuting power”—that

“the prosecutor picks some person whom he dislikes or desires to embarrass, or selects some group of unpopular persons and then looks for an offense.” Documents dating back to 2007 and testimony from numerous witnesses demonstrate that ExxonMobil told the truth about how it took climate risk into account. Having found no objective evidence of fraud, the NYAG conducted an internal audit to try to find an inconsistency. When it found no inconsistencies, it manufactured one. The NYAG hired experts to construct a narrative about a unitary carbon price that is contrary to the facts and immaterial to any reasonable investor. This contrived narrative cannot support the NYAG’s allegations of fraud. ExxonMobil respectfully requests judgment in its favor on all counts.

Dated: October 7, 2019
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Respectfully submitted,

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Certification of Compliance

Pursuant to the so-ordered joint pre-trial stipulation (NYSCEF Dkt. 334), I hereby certify that this brief is no longer than 45 pages, exclusive of the caption, table of contents, table of authorities, and signature block.

Dated: October 7, 2019
New York, New York

By: /s/ Theodore V. Wells, Jr.
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